



## MAKING PETER, TOM, DICK AND HARRY PAY FOR PAUL'S FOLLIES

*Regulatory Exceptionalism to Pacta Sunt Servanda during  
Performance of Public Contracts in India*

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**Abstract:** The doctrine of *Pacta Sunt Servanda* revolves around the necessity of ensuring that reliable promises are made; and that any defaults by either party are properly evaluated and addressed during adjudication of contractual disputes. As an international best practice, this doctrine is always applied strictly with very few permissible exceptions; and in certain cases of public contracts, additional theories of *exceptionalism* operate so as to protect public interest even in case of omissions by public officials vis-à-vis important requirements of public procurement policy. India, on the other hand, recently witnessed certain orders by its premier regulator in the electricity sector, where the *Pacta Sunt Servanda* doctrine was substantially derogated from, potentially resulting in misallocation of risk and liability. This short academic paper examines in detail certain procedural and substantive deviations by the Indian regulator, either expressly or impliedly, and concludes with suggestions for restoring the balance in public contracts, with a view to ensuring reliability of contractual promises made in public domains. “Exceptionalism” is a key defining construct of the legal framework for government procurement in the United States—one that recognises a special status for the State in its public contracting activities by reducing the obligations or expanding the power of the US Government as a contracting party, as compared to purely private contracts<sup>2</sup>. To the extent

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<sup>2</sup> For an exceptionally insightful analysis of the doctrine of exceptionalism; see, generally, Schwartz, J. I., *The Centrality of Military Procurement: Explaining the Exceptionalist Character*

that the *State* is also a custodian of public interest, the *exceptionalism* doctrine therefore implicitly recognises a special status that safeguards cumulative public interest of US citizens as well. Relevant instances in this regard are special constitutional rights of the State not to be sued without its consent or without express waiver of its immunity<sup>3</sup> in the US, with the outcome that contractors, regulators and courts can go only upto certain limits and no further while claiming relief or while passing orders against the State. Similarly, the US Government cannot be enjoined from further unauthorised use of third-party intellectual property rights, or be subjected to enhanced damages for their willful infringement during the performance of a government contract<sup>4</sup>, thereby granting primacy to the rights of US citizens to uninterruptedly avail public goods and services over competing claims for third-party IPR protection. Yet another instance of *exceptionalism* operating in favour of public interest in the US is the “Christian” doctrine, which permits the incorporation by operation of law, of mandatory contract clauses that express a significant or deeply ingrained strand of US public procurement policy, if procurement policies are being avoided or evaded, either deliberately or negligently, by lesser officials. In some cases, it has also been applied to incorporate less fundamental or significant mandatory clauses if they were not written to benefit or protect the party seeking the incorporation<sup>5</sup>. Thus, even if a public procurement contract in the US fails to specifically provide for an important clause, either because of omission or collusion by/of officials, the clause can be “read into” the public contract if it represents a significant, deeply-ingrained strand of US public procurement policy. Simultaneously, certain evolving legal developments in the EU seem to indicate an even harsher type of the *Christian* doctrine, where for the first time in 2004, the Regional Court of Munich stated an exception from the dogma that there could not be any detraction of concluded public procurement contracts because of an infringement

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of United States Federal Public Procurement Law (2004) available at [http://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=2024&context=faculty\\_publications](http://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=2024&context=faculty_publications).

<sup>3</sup> For details, see, generally, Jackson, V.C., *Suing the Federal Government: Sovereignty, Immunity and Judicial Independence*(2003) available at <http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1111&context=facpub>. See, also, Porter, R., *Contract Claims Against the Federal Government: Sovereign Immunity and Contractual Remedies*, (2006) available at [http://www.law.harvard.edu/faculty/hjackson/ContractClaims\\_22.pdf](http://www.law.harvard.edu/faculty/hjackson/ContractClaims_22.pdf).

<sup>4</sup> See, e.g., Bergmann, W.C., and Bukola, A., *Intellectual Property Rights in Government Contracts* (2009) available at [http://www.bakerlaw.com/files/Uploads/Documents/News/Articles/INTELLECTUAL%20PROPERTY/Andrews\\_Litigation\\_Reporter\\_Bergmann\\_Aina\\_7-2009.pdf](http://www.bakerlaw.com/files/Uploads/Documents/News/Articles/INTELLECTUAL%20PROPERTY/Andrews_Litigation_Reporter_Bergmann_Aina_7-2009.pdf).

<sup>5</sup> Cohen Seglias, *Christian doctrine*, available at <http://www.cohenseglias.com/federal-contracting-database/christian-doctrine>.

of (European) Public Procurement Law<sup>6</sup>. The Court essentially held that under special circumstances, there could be a right for a public authority to terminate a contract as *ultima ratio* (a means of last resort) where there was an infringement of EU procurement law.

India, on the other hand, has a large number of cases where the State is usually at the receiving end, with little recognition of underlying public policy implications of such adversarial pronouncements: that undue financial hardship or injunctions against the State and against state/ public utilities amount to, in effect, undue financial hardship and injunctions against Indian citizens who are the ultimate financers and consumers of relevant public goods and services. Realistically speaking, the negotiating authority of consumer/citizen stakeholders is too dispersed for them to effectively match strong litigation resources available with private parties making claims against the State or against state public utilities; and it therefore stands to reason that public fora tasked with adjudicating upon disputes involving such stakeholders may need to exercise some basic degree of caution and due diligence in the interest of meaningful and fair resolution of disputes relating to public contracts.

## I. INTRODUCTION

India recently witnessed two such orders<sup>7</sup> by the Central Electricity Regulatory Commission<sup>8</sup> (CERC)—India's premier electricity regulator—that passed on added costs to public utilities engaged in purchase of power from certain private entities, and thereby in effect, added costs to electricity consumers, arising out of certain input costs whose risks under contract were required to be borne and absorbed by electricity producers. In effect, these orders confirmed and considerably expanded the interim orders<sup>9</sup> that were issued in this regard sometime last year. The dispute before the regulator related to electricity tariffs that were the result of a fixed-price contract settled by a competitive bidding process; and certain electricity producers subsequently claimed higher tariffs ostensibly attributable to new, unforeseen, post-award coal pricing regulations by the Indonesian Government. The regulator has allowed claims for compensatory tariffs outside

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<sup>6</sup> Marschner, E., *Contract and Adaptation of Contracts in the European Public Procurement Law—A Comparative Study on the German and English Law of Public Procurement(2007)* available at <http://www.nottingham.ac.uk/pprg/documentsarchive/phdconference2007/contractandadaptationofcontractsintoeuropeanpublicprocurementlawerikmarschner.pdf>.

<sup>7</sup> *Coastal Gujarat Power Ltd. v. Gujarat Urja Vikas Nigam Ltd.*, Petition No. 159/MP/2012, February 22, 2014, available at <http://www.cercind.gov.in/2014/orders/SO159.pdf>. See, also, *Adani Power Ltd. v. Uttar Haryana Bijli Vidyut Nigam Ltd.*, Petition No. 155/MP/2012, February 22, 2014 (“Adani Power Ltd.”) available at <http://www.cercind.gov.in/2014/orders/SO155N.pdf>.

<sup>8</sup> Official Website: [www.cercind.gov.in](http://www.cercind.gov.in).

<sup>9</sup> See, e.g., *Coastal Gujarat Power Ltd. v. Gujarat Urja Vikas Nigam Ltd.*, Petition No. 159/MP/2012, April 15, 2013, available at [http://www.cercind.gov.in/2013/orders/159\\_mp\\_2012.pdf](http://www.cercind.gov.in/2013/orders/159_mp_2012.pdf). (“Coastal Gujarat Power Ltd.”).

of the contractual framework, in the process, making Indian electricity consumers and citizens pay for public and private welfare in Indonesia<sup>10</sup>, against cost risks that were to be borne by electricity producers themselves. While this leaves virtually no incentive for minimisation of input costs by electricity producers, a far more problematic dimension of these orders is the resultant disruption of the sanctity of a competitive public contracting process<sup>11</sup>, other than disruption of the sanctity of contracts caused by these regulatory interventions. All this, when there was clear evidence before the CERC that *force majeure* or *change of law* clauses in the contracts did not apply to the benefit of private parties in the instant case; and that risks of input costs fluctuation were consciously borne by the private parties while entering into these contracts.

Given the significant cost implications on public utilities and electricity consumers, the CERC orders have generated considerable public attention and debate in India<sup>12</sup>. In view of this public interest background, and without commenting on the merits of the dispute before the CERC, this short academic paper explores some of the important legal complications that could emanate from various procedural and substantive aspects of the CERC orders. A proper legal analysis is particularly important in light of the minority opinion<sup>13</sup> expressed during the first interim orders of the CERC, where one dissenting member had noted adverse implications of excessive regulatory intervention on contractual disputes between electricity producers and procurers. The issues raised in the dissenting opinion at the time of the interim orders, even though important from public policy and legal perspectives, remain unaddressed and unattended to even at the time of the final orders that were issued by the CERC recently.

## II. REGULATION VS. DISPUTE-HANDLING

Under Section 79(1)(b) of the Electricity Act<sup>14</sup> 2003, the CERC has the authority to regulate tariffs of generating companies other than those owned or controlled by the Central Government as specified in Section 79(1)(a), if such

<sup>10</sup> Gulzar, N., Moral Hazard from CERC Ruling is a Reflection of India's Corporate Culture (2013) available at <http://gulzar05.blogspot.in/2013/04/moralhazard-from-cerc-ruling-is.html>.

<sup>11</sup> Varottil, U., CERC Order in the Adani Power Case (2013), available at <http://indiakorplaw.blogspot.in/2013/04/cerc-order-inadani-power-case.html>.

<sup>12</sup> See, e.g., State Utilities upset by recent CERC orders in favour of Adani Power and Tata Power, The Economic Times (March 3, 2014) available at [http://www.livemint.com/Industry/PegcwBtILxHhBm5gbVyN5H/CERC-bails-out-Tata-Power-states-may-challenge-order.html](http://articles.economictimes.indiatimes.com/2014-03-03/news/47859291_1_new-tariff-norms-tariff-regulations-private-power-producers; Why CERC's compensation to Tata, Adani for high coal prices sets dangerous precedents and dents competition, The Economic Times, (March 2, 2014) available at http://articles.economictimes.indiatimes.com/2014-03-02/news/47799790_1_central-electricity-regulatory-commission-tata-power-and-adani-high-coal-prices; CERC bails out Tata Power, states may challenge order, Mint, February 22, 2014, available online <a href=).

<sup>13</sup> Coastal Gujarat Power Ltd., supra note 9.

<sup>14</sup> Section 79(1)(b), The Electricity Act, 2003, available at [http://powermin.nic.in/acts\\_notification/electricity\\_act2003/pdf/The%20Electricity%20Act\\_2003.pdf](http://powermin.nic.in/acts_notification/electricity_act2003/pdf/The%20Electricity%20Act_2003.pdf).

generating companies enter into or otherwise have a composite scheme for generation and sale of electricity in more than one State. However, the CERC's jurisdiction to handle disputes regarding tariffs set under its Section 79(1)(b) authority is covered by Section 79(1)(e) of the Electricity Act, which *mandatorily requires* the CERC to *refer such disputes to arbitration*; and the CERC can itself appoint an arbitrator<sup>15</sup> under certain circumstances if not provided under contract. These powers of the CERC to adjudicate can at best be delegated to members of the Commission itself<sup>16</sup>; and cannot be delegated any further<sup>17</sup>. The principle contained in the law therefore clearly seems to be that the electricity regulator, while adjudicating upon contractual disputes, should not retain for itself the role of an arbitrator; and that while adjudicating upon disputes, the CERC must maintain an arms-length distance at all times in the interest of fair play between competing interests of producers, procurers and consumers.

In the instant case, while exercising its jurisdiction to adjudicate upon disputes with regard to tariffs already set, the CERC did not refer the dispute for arbitration as required by law, but implicitly *read* the power to adjudicate into disputes *within its authority to regulate tariffs*<sup>18</sup> under Section 79(1)(b) of the Electricity Act, even though the Electricity Act clearly differentiates between *regulation of tariffs per se* and *adjudication of disputes* by providing two *different sub-sections* for each of these legal actions. This seemingly procedural deviation in the CERC's orders is important in view of its substantive implications, as under the Arbitration and Conciliation Act<sup>19</sup> 1996, an arbitral tribunal has the authority, at the request of either party to a dispute, to order any party that it take any interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject matter of the dispute<sup>20</sup>. In addition, this Act also empowers a party to a dispute to make an application to a Court of competent jurisdiction for taking certain specific interim measures<sup>21</sup> in relation to contract performance during the course of arbitral proceedings already underway. Therefore, even if the contractual dispute had indeed been referred to by the CERC for arbitration as required by the Electricity Act, the ability of either party to the dispute to request interim orders from such fora would not have been impaired at all.

One problem with the CERC orders therefore is that it mixed up powers of regulation of tariffs under Section 79(1)(b) with powers of dispute handling under Section 79(1)(e), when the legal requirements for the two are procedurally and substantively different. A second problem is that the CERC, while adjudicating upon a contractual dispute between two parties, assumed *unto itself* the role of

<sup>15</sup> Section 158, The Electricity Act, 2003.

<sup>16</sup> Section 143, The Electricity Act, 2003.

<sup>17</sup> Section 97, The Electricity Act, 2003.

<sup>18</sup> Coastal Gujarat Power Ltd., *supra* note 7; Adani Power Ltd., *supra* note 7 .

<sup>19</sup> Arbitration and Conciliation Act, 1996 available at <http://keralamediation.gov.in/AC%20Act.pdf>.

<sup>20</sup> Section 17(1), Arbitration and Conciliation Act, 1996.

<sup>21</sup> Section 9, Arbitration and Conciliation Act, 1996.

an arbitrator—something that Section 79(1)(e) of the Electricity Act clearly does not provide for. Thirdly, the CERC utilised the services of an ad-hoc committee to assist it in resolving the dispute<sup>22</sup> rather than the arbitration methodology required by the Electricity Act. In the process, the CERC has also failed to maintain an arms-length distance between the process of regulation of tariffs and the process of resolution of contractual disputes, as was clearly envisaged under the Electricity Act. This is important, as on an earlier occasion in the instant dispute, the Chairman of the CERC had expressed a clear preference for requiring resolution of contractual disputes by core processes of arbitration<sup>23</sup>, rather than using tertiary authority of the regulator for mediating and influencing contractual risk and liability allocation between electricity producers and procurers.

### III. TRANSPARENCY AND CONSULTATION REQUIREMENTS

Under Section 79(3) of the Electricity Act, the CERC is mandatorily required to ensure transparency while exercising its powers and discharging all its functions, including regulation of tariffs and the process of adjudication of claims. It is for this reason that the CERC regulations require an extensive process of publication of proposed tariffs and public consultations thereon. As a fundamental legal corollary, the transparency and consultation protocols that apply to original tariff setting need to apply equally to the process of post-award tariff renegotiations, since otherwise the very purpose of embedding transparency and consultation as mandated by law can be easily frustrated by non-transparency during post-award renegotiation of contracts<sup>24</sup>.

As mentioned earlier, the CERC referred the dispute to an ad-hoc “expert” committee rather than to an arbitrator as was required by law; and this committee seems to have conducted its deliberations with considerable amount of secrecy, without holding any public consultations or publishing a draft report and inviting comments thereon. Rather, the Committee thought it fit to classify its report as “*Strictly Private and Confidential*”, a classification that is in clear

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<sup>22</sup> The full report of the ad-hoc expert committee is available at [http://www.cercind.gov.in/2013/Reports/COMREP\\_CGPL.pdf](http://www.cercind.gov.in/2013/Reports/COMREP_CGPL.pdf).

<sup>23</sup> AG says CERC can alter tariff. Will it?, Daily News and Analysis (August 30, 2012) at <http://www.dnaindia.com/money/report-ag-says-cerc-can-alter-tariff-will-it-1734391>.

<sup>24</sup> As a matter of fact, some of these pro-public consultation arguments were specifically brought to the notice of the CERC but did not get requisite due attention, perhaps due to the public policy focus of Prayas’ submissions instead of a legal and/ or regulatory focus. See, for instance, Prayas, Prayas submissions to CERC regarding petition for tariff revision filed by Coastal Gujarat Power Ltd. (Mundra UMPP) (2013) available at <http://www.prayaspune.org/peg/publications/item/239-prayas-submissions-to-cerc-regarding-petition-for-tariff-revision-filed-by-coastal-gujarat-power-ltd-mundra-umpp.html>. See also, CERC suggested to hold public hearing on tariff issues, Mint (August 27, 2013) available at <http://www.livemint.com/Industry/9NOJM6JwuwPwAw2i2l0DFP/CERC-suggested-to-hold-public-hearing-on-tariff-issues.html>.

contradiction to transparency principles laid down under Section 79(3) of the Electricity Act. It is easy to see that if the Electricity Act requires the CERC itself to observe transparency in exercising its powers and discharging its functions, then this principle of transparency automatically flows down into the conduct of any body that performs any functions assigned to it by the CERC, as otherwise core transparency requirements imposed by law on the CERC can be simply whittled down by delegation of functions by the CERC.

In sum and on deeper examination, it appears that the ad-hoc committee has deviated the transparency requirements enshrined in the Electricity Act by: (i) not inviting public comments on the dispute referred to it by the CERC; (ii) by not publishing an interim report in the public domain asking for public comments thereon; and (iii) by classifying its report as “Strictly Private and Confidential”, when instead the subject-matter before the Committee warranted it to conduct public consultations, and its report to be readily available to the public for inputs and/ or comments. In its final orders, the CERC did not take note of the requirements of Section 79(3) that needed to be satisfied by the CERC itself, as well as by the ad-hoc committee functioning in pursuance of its directions. The submissions of merely one consumer organisation and two consumers who proactively got themselves impleaded before the CERC in some form were treated by the regulator as “adequate opportunity to interested parties”, when Section 79(3) of the Electricity Act clearly required the CERC to proactively involve consumers in a far more transparent and meaningful manner. In this context, it may be important to note that the Electricity Act provides for a Central Advisory Committee (CAC) to advise the CERC on, inter alia: (i) major questions of policy; (ii) matters relating to continuity of services by licensees; and (iii) protection of consumer interest<sup>25</sup>. Even though all three elements listed above were attracted in the facts and circumstances of the case, the CERC did not consider referring the matter to the CAC for its advise at any stage of the regulators’s interim or final orders on the dispute.

Thus, a critical legal deficiency with this new development is the lack of involvement of important stakeholders in the process. Both electricity consumers and public stakeholders have rights originating from the Electricity Act, as well as from CERC’s own regulations, to be involved in determination (and as a natural corollary, in re-determination) of tariffs. While the original tariffs were set through an elaborate process of public consultations, the re-negotiation thereof has now been conducted without following an equally transparent and consultative process, merely by adopting a different phraseology of a “compensation package” for the re-negotiation exercise<sup>26</sup>, which, de facto, amounts to tariff renegotiation, and one that could therefore have been done only through open consultations as envisaged under the Electricity Act.

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<sup>25</sup> Section 81, The Electricity Act, 2003

<sup>26</sup> For details of the compensation package determined by the CERC; see, *supra* note7.

#### IV. DOCTRINE OF IMPOSSIBILITY AND FRUSTRATION OF CONTRACTS

Separately, the Indian Contract Act<sup>27</sup> 1872 contains abundant guidance on “impossibility of performance” and “frustration” of contracts. Under these provisions, contracts can be voided by a party unable to perform its contractual obligations due to unforeseen circumstances only after claiming “impossibility of performance” or “frustration of contract”, but commercial hardship cannot be a ground for invoking such claims<sup>28</sup>. In fact, if the circumstances are such that a promising party would have known, upon due diligence, contract performance to be impossible in the first instance, then it is the promisors (in the instant case, the electricity producers) who would need to compensate the promisees (i.e. state utilities)<sup>29</sup> and not vice-versa.

The claim by electricity producers that their contracts had been frustrated was contained in the petition the CERC, but it is not known if there was any insistence by the CERC to require the claimants to comply with certain basic and preliminary requirements usually needed for successful invocation of impossibility and frustration under the Indian Contract Act. This is particularly important, since Section 175 of the Electricity Act clearly establishes that the provisions of the Electricity Act (and therefore, implicitly, the orders of the CERC) are *in addition to* and *not in derogation of* the provisions of *any other law in force*. As a corollary, the regulatory or dispute-handling authority could not have been in derogation of the Indian Contract Act laying down the substantive and procedural requirements for claiming impossibility and/ or frustration of contracts. In fact, in this case, there were two ways in which electricity producers could have claimed impossibility and frustration: *firstly*, under their contracts with Indonesian suppliers before an appropriate forum<sup>30</sup> in order to avoid the burden of Indonesian regulations; and *secondly*, before an Indian arbitral or judicial forum<sup>31</sup>, in respect of their contracts with electricity procurers. It appears that electricity producers made no claims in respect of the effects of Indonesian regulations on their contracts with Indian purchasers before either of these fora.

In this connection, it is also pertinent to note that Section 63 of the Electricity Act requires the CERC to adopt the tariff if such tariff has been determined through transparent process of bidding in accordance with the guidelines issued

<sup>27</sup> Indian Contract Act, 1872 available at <http://comtax.up.nic.in/Miscellaneous%20Act/the-indian-contract-act-1872.pdf>.

<sup>28</sup> For an insightful discussion on impossibility of performance and frustration under the Indian Contract Act, including important case law; see, Sharma, G., Impossibility of Performance and Frustration, available at <http://drgokuleshsharma.com/pdf/frustration.pdf>.

<sup>29</sup> Section 56, Indian Contract Act, 1872.

<sup>30</sup> The particular forum as agreed under their cross-border contracts with Indonesian suppliers of coal.

<sup>31</sup> As applicable under relevant provisions of the Electricity Act read with the Arbitration and Conciliation Act.

by the Central Government, which indeed was the case with the present controversy. However, in effect, the CERC has ended up modifying the tariff it had adopted earlier, including changing the fundamental risk-allocation principles forming part of contracts concluded under policies on competitive determination of tariff issued by the Central Government: an intervention that could be seen as being non-compliant with Section 79(4) of the Electricity Act that requires the CERC to be guided by, inter alia, the tariff policy published by the Central Government.

## V. INTERNATIONAL BEST PRACTICES ON SANCTITY OF CONTRACTS

In international legal practice, *sanctity of contracts* and *reliability of promises* are typically considered to be core principles of contractual relationships under the principle of *pacta sunt servanda* (agreements must be kept) that has evolved over time<sup>32</sup>. Over a period of time, in view of practical commercial experience, two limits to this principle have evolved: (i) *clausula rebus sic stantibus* (contract contained an implied term that certain important circumstances remain unchanged); and (ii) *jus cogens* (compelling law). Of these two competing principles, the former *clausula rebus sic stantibus* is of relevance to severe commercial hardship; whereas the latter *jus cogens* refers to certain fundamental, overriding principles of international law such as crimes against humanity and law of genocide from which no derogation is ever permitted.

In the UK, for instance, under the *clausula* principle, “frustration” can be invoked by an affected party to void a contract where a change of circumstances makes the performance drastically dissimilar from what was originally agreed upon in the contract. Similarly, in the US, “impracticality” can be invoked as a defence for non-delivery, if performance has been made impracticable by the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract was made<sup>33</sup>. This exception therefore is applied very narrowly in most legal jurisdictions; and dispute resolution fora typically require claimants to prove all of the following elements: (i) *lack of foreseeability and lack of risk-allocation*; (ii) *exploration of alternative performance*; and (iii) *timely notice*<sup>34</sup>. Public procurement law governing federal contracts in the US is equally strict in its treatment of claims of exemption from non-performance due to impracticality of performance; and a contractor needs to clearly show: (i)

<sup>32</sup> Jiafeng, Y. (2010), A Study of Economic Hardship, copy available with the author. For an excellent treatment of grounds for exemption from contractual duties; see, also, Kull, I., About Grounds for Exemption from Performance under the Draft Estonian Law of Obligations Act (2001) available at [http://www.juridicainternational.eu/public/pdf/ji\\_2001\\_1\\_44.pdf](http://www.juridicainternational.eu/public/pdf/ji_2001_1_44.pdf).

<sup>33</sup> Id.

<sup>34</sup> Augenblick, M., and Rousseau, A.B., Force Majeure in Tumultuous times: Impracticality as The New Impossibility(2012) available at <http://www.pillsburylaw.com/sitefiles/publications/bylinedarticleforcemajeureintumultuoustimesjournalofworldinvestmenttrade031312.pdf>.

that performance is *substantially more difficult or expensive* than foreseen by the parties at the time of entering into a contract; and (ii) that it has *not assumed the risk of this difficulty or risk either by agreement or by custom*. Under these narrow requirements, claims by contractors typically fail, for instance in the case of fixed-price contracts with conscious assumption of input cost risk, and where cost fluctuations are considered as normal, foreseeable risks in the ordinary course of business<sup>35</sup>.

These principles are similar to the Indian law, and require the change in circumstances to grave and to not have been specifically addressed at the time of contract formation. In contrast, a perusal of the CERC orders shows that the risks of input cost escalations were consciously borne by the electricity producers at the time of entering into contracts with procurers. Thus, the CERC's orders have had the effect of overturning a cardinal principle of contracts in India, by granting benefits to a non-performing supplier on account of commercial hardship, and diluting in the process core doctrinal requirements of "impossibility" and "frustration" that are important elements of the legal framework of the Indian Contract Act as well as of best international practices.

## VI. CVC'S OVERSIGHT GUIDANCE ON RENEGOTIATION OF PUBLIC CONTRACTS

It is interesting that these benefits have been granted to electricity producers in a non-transparent manner, without fully taking into account the legal rights of consumers or of the general public. In this connection, it is important to note that in the interest of transparency and competition in public contracts, oversight and regulatory guidance in India typically requires public authorities to ensure that variation in terms and conditions of contracts should not be resorted to as a matter of routine. At the pre-contract stage, for instance, any variation in an RFP needs to be notified to all potential bidders, giving them adequate time and opportunity to comment on such changes, or to file revised bids. Insofar as post-award changes to public contracts are concerned, the Central Vigilance Commission<sup>36</sup> (CVC) guidance on contract administration<sup>37</sup> issued in 2002 specifically requires that any relaxation in contract terms should be severely discouraged after conclusion of a contract; and in exceptional cases where modifications are considered absolutely essential, the same can be allowed only after taking into account corresponding financial implications. These instructions apply equally to contracts awarded by the Government, as well as contracts awarded by state utilities that have been affected by the CERC orders. Against this back-

<sup>35</sup> Cibinic Jr., J, Nash Jr., R.C., and Nagle, J.F., *Administration of Government Contracts*, 314-322, (Wolters Cluwer, 4th edn., 2006).

<sup>36</sup> Official Website: [www.cvc.nic.in](http://www.cvc.nic.in).

<sup>37</sup> Central Vigilance Commission (2002), *Common Irregularities/ Lapses Observed in Award and Execution of Electrical, Mechanical and Other Allied Contracts and Guidelines for Improvement thereof*, ¶22.1.5, available at <http://cvc.nic.in/COMMON%20IRREGULARITIES.pdf>.

ground, the regulator's orders grant favourable post-award concessions to electricity producers at variance with originally agreed terms and conditions of signed public contracts: a change strongly discouraged by the CVC from procurement integrity perspectives.

## VII. FORUM SHOPPING AND EXHAUSTION OF REMEDIES

The orders under examination showcase the severe public interest implications of unbridled forum shopping, arising out of the failure to require exhaustion of remedies by claimant parties. In the *first* instant, the *impossibility* effects of Indonesian regulations should have been agitated by electricity producers before the appropriate forum under their contracts with Indonesian suppliers of coal: something that was apparently not done. *Secondly*, the case clearly required electricity producers to agitate their dispute before an Indian arbitral forum, both under the dispute-handling provisions of the Electricity Act, as well as under specific contractual arrangements that were governed by provisions of the Indian Contract Act and the Arbitration and Conciliation Act. But instead, the instant dispute was handled directly by the CERC itself, without invoking an arms-length arbitration process. *Thirdly*, if at all the dispute was to be referred to a committee rather than the arbitrator, a proper course of action under the Electricity Act was for the CERC to refer it to the CAC rather than an ad-hoc committee as has happened in the instant case that could have placed better legal resources with the committee members<sup>38</sup>.

An important evidence regarding potential forum shopping in this case is that an electricity producer had separately filed a petition in April 2013 before one of the state regulators—the Rajasthan Electricity Regulatory Commission (RERC)—requesting for essentially identical reliefs as had been sought from the CERC. This was followed by the filing of an interlocutory application (IA), within a fortnight of the main petition, asking the RERC to allow an ad-interim pass-through of imported coal costs<sup>39</sup>. While the main petition is still before the state regulator at the time of writing this paper, the IA was not accepted by the RERC, and a final order disposing off the IA was issued on January 2014 by the RERC—a full month before the CERC's final orders under analysis. Strangely, the state utilities failed to bring these important developments to the notice of the

<sup>38</sup> Even though the ad-hoc “expert” committee utilised the services of a legal consultant, it is clear from a bare reading of various legal defects in the dispute-handling process outlined in this paper that this committee remained bereft of proper legal advice on risk-allocation principles under the Indian Contract Act.

<sup>39</sup> Adani Power Rajasthan Ltd. v. Jaipur Vidyut Vitran Nigam Ltd., Petition No. RERC-392 of 2013, dated 30-1-2014, available at <http://erc.rajasthan.gov.in/Orders/Order216.pdf>. See, also, CERC Tariff Hike may need State Regulator nod: Raj Discom, (February 25, 2014) available at [http://www.moneycontrol.com/news/business/cerc-tariff-hike-may-need-state-regulator-nod-raj-discom\\_1047804.html](http://www.moneycontrol.com/news/business/cerc-tariff-hike-may-need-state-regulator-nod-raj-discom_1047804.html).

ad-hoc committee as well as the CERC: that similar relief had been claimed by an electricity producer from the state regulator, or that the IA had been rejected by the state regulator; thus resulting in a situation where the CERC orders have remained oblivious and uninformed of these important legal developments.

Interestingly, the CERC also made the Central Government a respondent in the instant case, notwithstanding the superior position that the Central Government enjoys under the Electricity Act by way of: (i) issuing tariff policies under Section 3 of the Electricity Act; (ii) issuing policy directions under Section 107 thereof; and (iii) its power to make rules to be enforced by the CERC under Section 176 thereof. Thus, by reducing the Central Government to the status of *merely a respondent* in a specific dispute before the CERC that actually related to contract administration and adjudication between two other parties, the CERC has inadvertently derogated the position that the Central Government enjoys under law. If, for instance, the Central Government were now omit to refer or appeal in the matter before an appropriate forum so as to uphold sanctity of concluded contracts or to uphold the importance of transparent stakeholder consultations, the Central Government could well find itself being hit by principles of *res judicata*. The resulting natural implication would be that the one important policy and rule-making institution/forum—the Central Government—that is expected to uphold the rights of consumers and citizens could find its hands tied down, thereby making protection of public and stakeholder interests dependent upon the inefficiency of public policy processes. In the instant case, the problem has been compounded further because the state public utilities—the procuring entities under the relevant public contracts—failed to properly highlight important legal aspects while filing counters before the CERC and the ad-hoc committee. As can be easily seen from a bare perusal of the counter-submissions now available in the public domain, the state utilities made a number of unclear submissions couched in usual official/ administrative language, rather than presenting strong and narrow arguments with clear legal bases, when the latter would have been a far more effective litigation strategy for protection of their own commercial interests, as well as the interests of electricity consumers in the affected states.

## VIII. CONCLUSIONS

The legal aspects of regulatory exceptionalism in the instant cases appear to have significant implications meriting urgent attention of governance institutions, while offering insightful glimpses to legal researchers and students into potential misallocation of risk and liability by dispute resolution fora. The instant cases contain a number of interesting departures from the requirements laid down by law for contract enforcement and electricity regulation in India, such as: (i) the regulator utilising the services of an ad-hoc committee that remained ill-informed of legal nuances, instead of using the proper committee as required under law; (ii) using an authority of direct regulation for dispute resolution, thereby

intervening in contracts concluded under principles adopted and approved by the regulator itself, instead of using its authority of arms-length dispute-handling through arbitration; (iii) diluting the principles of transparency and advance stakeholder consultations as mandated by law for tariff-setting (and by extension to tariff renegotiations) by adopting the different phraseology of a “compensatory tariff”; and (iv) derogating from well-established principles of frustration and impossibility of contracts, with resultant misallocation of risk and concomitant liabilities to parties that are in no position to control the risk of input costs<sup>40</sup>. Given critical legal implications as outlined above, the regulator’s orders may need urgent attention of affected Central and State Governments as custodians of public interest, as well as individual consumers and other stakeholders who have been adversely affected in the process. Prima facie, as outlined earlier, the regulator’s orders go against the basic principles contained in the Indian Contract Act, as well as procedures for tariff re-determination under the Electricity Act.

The cases examined in this short paper also highlight the imperative need for adequate capacity-building amongst regulators in India, particularly on theories of law and theories of contracts<sup>41</sup>, as otherwise, regulators in India may tend to view their work as merely a technical one, without the need to properly appreciate and mitigate full public policy and legal implications of regulatory intervention and exceptionalism. In addition, they may need to also appreciate the importance of continuing and *open adversarial* argumentation, rather than mere reliance on in-house consultation and expertise. This may be of importance particularly in developing countries where it is relatively easier for vested interests to not only dominate public debate and discourse, but also operate in public policy spaces with tacit approval or oversight of at least some of the important stakeholders. The suggested course corrections are important, as else, we might increasingly witness post-award benefits and bailouts mediated by regulators, either because of inadvertent omissions or because of regulatory/ state utility capture, and the exercise of tertiary regulatory authority may end up side-stepping relatively core legal requirements—as established by the Indian Contract Act, as well as legal authority of the State to control its contracts under the Indian Constitution and the compliance authority of institutions such as the CVC—all in one single shot.

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<sup>40</sup> Fundamentally, the public-private partnership mechanism is essentially based on the concept of passing on to private concessionaires/ parties the risks that they are more qualified to assume or to control; see, e.g., Mairal, H.A., *The Impact of Public Procurement and Rules of Government Contracting on Public Spending and Attracting Private Infrastructure Investment (2007)*, available at <http://www.uncitral.org/pdf/english/congress/Mairal.pdf>.

<sup>41</sup> Verma, S., *Dispute Resolution in Public Contracts*, SSRN (2013), available at <http://ssrn.com/abstract=2267056>.